

Message Text

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PASS TREASURY AND FEDERAL RESERVE BANK

E.O. 11652: GDS

TAGS: EFIN, HK

SUBJECT: REGULATION OF INVESTMENT BANKS, FINANCE COMPANIES, ETC.

1. SUMMARY: INFLUX OF INTERNATIONAL BANKS INTO HONG KONG BY ESTABLISHMENT OF "INVESTMENT BANKS" HAS PROVOKED INCREASING RESISTANCE FROM TWO LEADING LOCAL LICENSED COMMERCIAL BANKS. HKG, WHICH IS FAVOR OF MORE INTERNATIONAL COMPETITION, IS IN PROCESS OF DEVELOPING PROPOSALS, IN CONSULTATION WITH FINANCE COMPANIES AND BANKS, TO MORE OR LESS PRESERVE STATUS QUO WHILE OFFERING SMALL ADDITIONAL BENEFITS TO BOTH SIDES. ON THE OTHER HAND OPERATIONS OF LOCAL SMALLER CHINESE FINANCE COMPANIES MAY BE EFFECTED BECAUSE GOVERNMENT WILL RESTRICT THEIR ABILITY TO ATTRACT DEPOSITS IN INTERESTS OF PROTECTING SMALLER DEPOSITORS.

2. BASIC ISSUE IS CLASH BETWEEN FINANCIAL SECRETARY'S DESIRE TO IMPROVE HONG KONG'S POSITION AS REGIONAL FINANCIAL CENTER, BY ENCOURAGING INTERNATIONAL FINANCIAL INSTITUTIONS TO USE IT AS BASE OF OPERATIONS, ON ONE HAND, AND HONG KONG BANK AND CHARTERED
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BANKS'S DESIRE TO PREVENT THEIR DEPOSIT BASE AND HIGHLY PROFITABLE

SPREAD BETWEEN DEPOSIT LENDING RATES FROM BEING ERODED ON THE OTHER. INFLUX OF BIG U.S., JAPANESE AND SCATTERING OF U.K. AND CONTINENTAL BANKS ESTABLISHING "FINANCING COMPANIES," COMPLETELY FREE FROM REGULATION, HAS PROVOKED STRONG BANK RESISTANCE. ANOTHER BANK OBJECTIVE RELATED TO THEIR PROFITS WAS THE REMOVAL OF WITHHOLDING TAX ON DEPOSIT INTEREST, OSTENSIBLY TO ENCOURAGE ASIAN DOLLAR MARKET, BUT MAINLY TO GIVE THEMSELVES THE SAME TAX STATUS AS INSTITUTIONS BORROWING ABROAD AND RELENDING ABROAD. FINALLY GOVERNMENT IS UNDER PRESSURE TO GRANT NEW BANKING LICENSES AND WOULD RATHER NOT CONSIDERING THAT THERE ARE OVER ALREADY 500 BANK BRANCHES FOR FOUR MILLION PEOPLE(SEE REF A)

3. NON-BANK FINANCIAL INSTITUTIONS ARE VERY HETEROGENEOUS GROUP RANGING FROM NEIGHBORHOOD SALES FINANCE COMPANIES TO SELF-STYLED INVESTMENT BANKS OWNED BY CONSORTIA OF LARGEST BANKS IN WORLD. UNDER BANKING LAW THEY ARE DISTINGUISHED FROM COMMERCIAL BANKS BY;

(A) PROHIBITION FROM ACCEPTING DEPOSITS WITH MATURITY OF LESS THAN 93 DAYS

(B) INABILITY TO USE WORK "BANK" IN THEIR TITLES AND

(C) TOTAL ABSENCE OF USUAL REGULATION - CAPITAL AND LIQUIDITY REQUIREMENTS, REGULAR REPORTS, AUDITS, ETC.

BANKING COMMISSIONER'S RECENT EFFORT TO CHART THIS UNKNOWN TERRITORY CAME UP WITH ROUGLY ONE HUNDRED COMPANIES DIVIDED INTO FIVE GROUPS AS FOLLOWS (NUMBER OF INSTITUTIONS IN PARENTHESIS):

(A) FOREIGN COMPANIES OWNED BY CONSORTIA (16)

(B) FOREIGN COMPANIES OWNED BY ONE SHAREHOLDER (38)(C) CHINESE COMPANIES (32)

(D) COMPANIES ENGAGED IN UNDERWRITING, ETC. (11)

(E) OTHERS, INCLUDING INSTALLMENT FINANCE, ETC. (9)

FIRST TWO CATEGORIES REPRESENT INTERNATIONAL BANKS, DEALING MAINLY IN EURODOLLARS, THA HAVE COME TO HONG KONG TO SEEK LOCAL OR REGIONAL BORROWERS. VERY FEW ARE MORE THAN TWO YEARS OLD. THIRD IS HODGE-PODGE ENGAGED IN STOCK BROKING, MONEY EXCHANGE, BUSINESS FINANCE, GOLD TRADING, ETC. FOURTH GROUP ARE MOSTLY U.K. OR AFFILIATED BROKERS OF LOCAL COMPANIES OF BRITISH ORIGIN. FIFTH IS CATCH-ALL THAT HAS NO OBVIOUS RATIONALE. MORE COMPANIES ARE BEING ADDED AND GROUPS C & E MAY BE ALTERED AS A RESULT.

4. WITH RESPECT TO 74 COMMERCIAL BANKERS, INFORMED LOCAL BANKERS LIMITED OFFICIAL USE

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ESTIMATE THAT ABOUT 70-75 PERCENT OF DEPOSITS BELONG TO HONG KONG BANK AND ITS AFFILIATE HANG SENG BANK, AND CHARTERED BANK. WITH PERHAPS 10 PERCENT UNDER CONTROL OF COMMUNIST BANKS, LED BY BANK OF CHINA, THIS LEAVES A MAXIMUM OF 20 PERCENT TO BE SHARED BY ROUGHLY 60 CHINESE AND FOREIGN INSTITUTIONS. THE BANKS ARE INSTITUTIONALLY LINKED TO GOVERNMENT BY BANKING ADVISORY COMMITTEE DOMINATED BY HONG KONG AND CHARTERED, THOUGH WHICH LEGISLATION RELATED TO THEM USUALLY PASSES.

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PASS TREASURY AND FEDERAL RESERVE BANK

5. GOVERNMENT APPROACH UNDER FINANCIAL SECRETARY HADDON-CAVE, IS LESS PRO-BUSINESS THAN HIS PREDECESSOR COOPERTHEWAITE, AND MORE WILLING TO SET GOVERNMENT GOALS AND PUSH PRIVATE ENTERPRISES TO ACCEPT THEM BY AN OCCASSIONAL STICK AS WELL AS CARROTS. BUT IN HONG KONG TRADITION, HE DISLIKES MEASURES REQUIRING LARGE GROUP OF BUREAUCRATS TO CARRY OUT.

6. PUSHED BY BANKS TO REGULATE FINANCE COMPANIES HKG INITIALLY PROPOSED PROTECTION OF DEPOSITOR'S BILL WHICH WOULD PREVENT NON-BANKS FROM ACCEPTING DEPOSITS OF LESS THAN HK\$100,000 (NEVER PUBLICIZED). ON THEORY THAT INDIVIDUALS WHO COULD PUT UP MORE THAN THAT WERE FINANCIALLY SOPHISTICATE DENOUGH TO TAKE CARE OF THEMSELVES

. THIS PROPOSAL WAS REFERRED TO BANKING ADVISORY COMMITTEE WHERE IT WAS BLOCKED. HKG REQUESTED AN ALTERNATIVE. JUST WHAT WAS PROVIDED IS NOT KNOWN, BUT PUBLIC COMMENTS BY BANKERS SUGGEST, THAT WHAT THE BANKS HAD IN MIND WAS BANKING-TYPE REGULATION WITHOUT BENEFIT OF BANKING LICENSE.

7. ON MAY 21, BANKING COMMISSIONER OCKENDEN LAUNCHED PUBLIC

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DISCUSSION OF WHOLE PROBLEM BY SPEECH TO LIONS CLUB. IN EARLY JUNE, HE CALLED MEETING OF FINANCE COMPANIES. THE DISCUSSIONS THAT HAVE BEEN TAKING PLACE ARE GRADUALLY SHAPING SERIES OF GOVERNMENT PROPOSALS WHICH:

(A) WOULD GIVE THE INVESTMENT BANKS A CHANCE TO ACQUIRE BANKING LICENSE WHILE DOING MUCH SAME THING AS THEY ARE NOW,

(B) CREATE FINANCE COMPANY ASSOCIATION WHICH WOULD TRY TO POLICE ITS MEMBERS AND SERVE AS SPOKESMEN FOR THE COMPANIES VIS-A-VIS THE GOVERNMENT,

(C) IMPROVE THE SOUNDNESS OF LOCAL FINANCE COMPANIES BY REQUIRING MINIMUM CAPITAL AND LIMITING THEIR ACCESS TO SMALL DEPOSITORS AND

(D) CONVINCE MAJOR LOCAL BANKS THAT ALL OTHER FINANCIAL INSTITUTIONS ARE UNDER SUFFICIENT CONTROL SO THAT THEIR HONG KONG DOLLAR DEPOSITS WILL NOT BE SIPHONED OFF.

8. IN EFFECT HIERARCHY BASED ON INCREASING SUBJECTION REGULATION AND LOCAL PRIVILEGES WOULD BE CREATED. AT THE BOTTON WOULD BE FINANCE COMPANIES WHO WOULD HAVE TO REGISTER, HAVE MINIMUM CAPITAL OF TENTIATIVELY HK \$5,000,000 HALF OF WHICH IS PAID IN AND MINIMUM SIZE DEPOSIT WHICH THEY COULD ACCEPT. THE NEXT STAGE, WHICH WOULD BE LIMITED BANKING LICENSES, WOULD GIVE FINANCE COMPANY ADDITIONAL PRIVILEGE OF CALLING ITSELF BANK, ACCESS TO INTER-BNAK MONEY MARKET IN WHICH ANY BANK IN LEGAL SENSE MAY TRADE AND POSSIBLY PERMISSION TO TAKE LARGE DEPOSITS FOR PERIODS OF LESS THAN 93 DAYS. FOR THESE PRIVILEGES, IT WOULD HAVE TO PUT UP HK\$25,000000 IN CAPITAL. ON TOP WOULD BE COMMERCIAL BANKS. SINCE HONG KONG BANK GROUP AND CHARTERED USUALLY ARE LENDERS IN INTER-BANK MARKET, THEY COULD BECOME SUPPLIERS OF RATHER THAN COMPETITORS FOR FUNDS IN RELATION TO INTERNATIONAL BANKS.

9. REACTION: FINANCE COMPANIES HAVE ORGANIZED THEMSELVES INTO FIVE GROUPS OUTLINED IN PAR. 2. CHAIRMAN OF THESE GROUPS FORM STEERING COMMITTEE. BASIC LINE OF DIVISION IS BETWEEN LOCALLY ORIENTED CHINESE FINANCE COMPANIES AND FOREIGN INVESTMENT BANKTYPE COMPANIES. LATER GENERALLY IN FAVOR OF OCKENDEN'S PROPOSAL INsofar AS FINANCE COMPANY PROPOSALS ARE CONCERNED

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WHILE FORMER ARE RESISTING INITIAL PROPOSAL OF HK \$200,000

DEPOSIT LIMITATION WHICH WOULD SERIOUSLY EFFECT THEIR BUSINESS OPERATIONS. BANKING ADVISORY COMMITTEE HAS REVIEWED PROPOSAL BUT HAS BEEN NON-COMMITTAL SO FAR. GOVERNMENT IS THINKING OF WORKING AT PROPOSAL IN NEXT SIX WEEKS WHICH WOULD BE SUBMITTED TO LEGISLATIVE COUNCIL IN OCTOBER OR NOVEMBER.

10. COMMNET: GOVERNMENT IS CLEARLY BENDING TO LOCAL BANKER PRESSURE IN PAST FEW MONTHS BUT IS STILL SEEKING COMPROMISE WHICH WILL MORE OR LESS PRESERVE STATUS QUO WHICH IT BELIEVES WILL PROMOTE HONG KONG'S DEVELOPMENT AS MORE SOPHISTICATED FINANCIAL CENTER. NEXT ACT SHOULD BE MAIN EVENT AND SHOULD INDICATE JUST HOW MUCH STRENGTH BANKERS AND HKG HAVE IN THIS MATTER.
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